

**Letter Report: Increased Oversight Is Needed
to Ensure Taxpayers Receive Credit for
Millions of Dollars in Excess Collections
Accounts**

July 2001

Reference Number: 2001-30-124

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

July 30, 2001

MEMORANDUM FOR COMMISSIONER, SMALL BUSINESS/SELF-EMPLOYED
DIVISION
COMMISSIONER, WAGE AND INVESTMENT DIVISION

Pamela J. Gardiner

FROM: Pamela J. Gardiner
Deputy Inspector General for Audit

SUBJECT: Final Letter Report - Increased Oversight Is Needed to Ensure
Taxpayers Receive Credit for Millions of Dollars in Excess
Collections Accounts

This report represents the results of our review of the Internal Revenue Service's (IRS) actions in response to recommendations made in our prior audit report entitled, *Millions of Dollars in Internal Revenue Service Excess Collections Accounts Could Be Credited to Taxpayers* (Reference Number 2000-30-088, dated June 2000). Our objective was to determine whether the actions taken in response to the prior audit report were effective in ensuring that taxpayer accounts were properly credited with monies identified by two computer matches we provided to the IRS.

In summary, the IRS has initiated procedural changes to the Internal Revenue Manual and has scheduled computer programming changes that should decrease the number of payments transferred to its Excess Collections Accounts in the future. However, increased oversight is still needed to ensure that all payments that can be credited to taxpayer accounts are appropriately transferred from Excess Collections.

We identified \$62.6 million¹ that was credited to taxpayer accounts based on our recommendations and validated by the IRS. These results were previously provided to and discussed with IRS management. The results from the second "clean-up" listing we

¹ These amounts are separate from those we identified in the prior audit report.

provided the IRS resulted in \$49.9 million being credited to taxpayer accounts from Excess Collections. We performed a sample review of both individual and business taxpayer accounts and identified an additional \$12.7 million could also be credited back to taxpayer accounts. We provided this information to the IRS, and the credits have since been transferred back to taxpayer accounts.

Management's response was due on July 23, 2001. As of July 25, 2001, management had not responded to the draft report.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and Corporate Programs), at (202) 622-3837.

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

Objective and Scope

We followed up to determine whether the actions taken in response to the prior audit report were effective in ensuring taxpayers receive credit for payments in Excess Collections Accounts.

The overall audit objective was to determine if the Internal Revenue Service (IRS) had taken corrective actions in response to a prior audit report entitled, *Millions of Dollars in Internal Revenue Service Excess Collections Accounts Could Be Credited to Taxpayers* (Reference Number 2000-30-088, dated June 2000).

Specifically, we followed up to determine whether the actions taken in response to the prior audit report were effective in ensuring that taxpayer accounts were properly credited with monies identified by two computer matches we provided to the IRS. In addition, we reviewed the status of IRS' programming changes that were designed to decrease the number of payments transferred from taxpayers' accounts to Excess Collections Accounts in the future.

We performed this audit from February to May 2001 in the Headquarters of the Wage and Investment and Small Business/Self-Employed Divisions in Atlanta, Georgia, and New Carrollton, Maryland, respectively. This audit was performed in accordance with *Government Auditing Standards*.

Major contributors to this report are listed in Appendix I. Appendix II contains the Report Distribution List.

Background

One of the IRS' strategic goals is to provide top quality service to each taxpayer.

One of the IRS' strategic goals is to provide top quality service to each taxpayer. An IRS guiding principle to link the strategic goals to actions is to understand the customer's point of view to prevent and solve problems and provide quality service. One area where the IRS can prevent and solve problems is with the Excess Collections process.

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

A payment is moved to the Excess Collections Accounts¹ when the payment cannot be associated with a specific taxpayer's account or when an identified taxpayer does not file a tax return. As of August 2000, there was approximately \$3.4 billion from 1.3 million taxpayers in the Excess Collections Accounts. When a payment is moved to Excess Collections, it is no longer associated with the taxpayer's account.

The IRS will make two attempts to contact the taxpayer before transferring a payment to Excess Collections. Once the payment is transferred, and the taxpayer later files his/her tax return, the payment is not automatically transferred back to the taxpayer's account, which can have negative consequences for the taxpayer. For example, the IRS will likely send a balance due notice to the taxpayer. Quick action is necessary within the IRS to prevent this from happening. Further, the IRS may take enforced collection actions.

Taxpayers do not always receive credit for certain tax payments transferred to Excess Collections Accounts.

In the June 2000 report, we stated that taxpayers do not always receive credit for certain tax payments that had been transferred to Excess Collections, since the process has computing systems limitations, procedural barriers, and legal restrictions.² The audit showed that approximately \$25 million needed to be immediately transferred from Excess Collections Accounts back to taxpayers' accounts. In implementing the recommendations from the June 2000 report, the IRS estimated it credited \$13.7 million to taxpayers' accounts from the first "clean-up" listing we provided.

¹ Excess Collections Accounts contain payments for both individual and business taxpayers.

² The Internal Revenue Code 26 U.S.C. § 6511(a), Limitations on Credit or Refund (1998), requires that the taxpayer file a claim for credit or refund of an overpayment within 3 years from the date the tax return was due or 2 years from the date the tax was paid, whichever period expires later. If no tax return is due, a claim for refund of prepaid credits must be made within 2 years from the date of payment.

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

The IRS has scheduled computer-programming changes to generate “OPEN” status listings in the future.

To assist the IRS in resolving these accounts, we provided two “clean-up” listings. The listings identified payments in Excess Collections Accounts that matched taxpayers’ accounts in the IRS’ Accounts Receivable records. We requested that the IRS provide the actual results from the resolution of these “clean-up” listings.

We also recommended that the IRS initiate a computer programming change to periodically generate “OPEN” status listings in the future. Additional programming changes were to be initiated to allow IRS systems to automatically generate a notice to the taxpayer every 6 months as a reminder that a credit is available and that a return must be filed to receive the credit. This notice would also explain the statute of limitations on the available credit.

Finally, we recommended that procedures be implemented to keep the credit on the taxpayer’s account where a tax return has not been filed, until the statute for refunding or crediting the overpayment has expired. This will assist the IRS in actively pursuing the taxpayer’s return and case resolution.

Results

Increased oversight is needed to ensure taxpayers receive credit for payments in Excess Collections Accounts.

Based on the second “clean-up” listing provided by the Treasury Inspector General for Tax Administration, the IRS reported that it credited taxpayers’ accounts with \$49.9 million from its Excess Collections. However, increased oversight is still needed to ensure that all payments that can be credited to taxpayers’ accounts are appropriately transferred from Excess Collections. Without sufficient oversight, taxpayers may receive incorrect balance due notices, send additional payments, or have collection enforcement actions taken against them, while their payments remain in the IRS’ Excess Collections Accounts.

The IRS has initiated procedural changes to the Internal Revenue Manual (IRM) and has scheduled computer programming changes that should decrease the number

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

of payments transferred to its Excess Collections Accounts in the future.

The IRS Needs to Ensure Oversight and Training Are Provided to Employees Working Future “OPEN” Status Listings

The second “clean-up” listing we provided the IRS identified \$69.8 million that could be associated with over 8,600 taxpayer accounts. Results from the IRS’ attempts to resolve the cases on this second “clean-up” listing showed that not all of the payments that could have been transferred from the Excess Collections Accounts were credited back to taxpayers’ accounts.

Over \$62 million was credited back to taxpayers’ accounts.

The IRS reported that it was able to credit \$49.9 million (71 percent) to taxpayers’ accounts. However, we completed a sample review of 236 Individual Masterfile³ (IMF) and Business Masterfile (BMF)⁴ high-dollar payments from the remaining approximately \$20 million and determined that an additional \$12.7 million (18 percent) could also be credited back to taxpayers’ accounts. We provided this information to the IRS, and the credits have since been transferred back to taxpayers’ accounts.

These taxpayers were not credited with the payments they had made because the IRS employees did not thoroughly research all of the taxpayers’ accounts to ensure proper application of the credits. For example, in 1 instance a payment of over \$10 million in the Excess Collections Account identified in the second “clean-up” listing was not returned to the taxpayer’s

³ The Masterfile is the IRS’ main computer system, containing accounts for individual (IMF) and business (BMF) taxpayers.

⁴ Where applicable, we selected the largest dollar payments (10 IMF and 10 BMF) from each service center’s listings and any additional payments that involved Tax Years 1998 and 1999, where the statute for refunding would not have expired.

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

The IRS requires examiners to thoroughly research taxpayers' accounts when applying credits.

account because the IRS examiner noted that it did not appear to belong to the taxpayer.

However, we researched the taxpayer's account and determined that it did belong to the taxpayer but for a different tax period than the one on the listing. The IRM states that if the payment belongs to the taxpayer, the examiner is to look for other tax periods with an outstanding balance. The IRS has since transferred the payment back into the taxpayer's account.

The IRS advised us that this situation occurred because the employees were instructed to review only the exact period on the "clean-up" listing rather than the entire account. In addition, IRS managers stated that the employees did not have the necessary training (i.e., Limitations on Credit or Refund) to properly apply credits to taxpayers' accounts.

As a result of not effectively researching the taxpayers' accounts, some taxpayers received incorrect balance due notices and some sent the IRS additional payments. In addition, the IRS took enforcement actions against some taxpayers, which not only burdens the taxpayers but also is costly to the IRS. In each of these cases, the taxpayers had payments in the Excess Collections Accounts.

As part of its corrective actions, the IRS is scheduled to implement its own "OPEN" status listing beginning in July 2001. However, taxpayers will continue to receive erroneous notices, make unnecessary payments, and be subjected to enforced collection actions if IRS examiners do not receive the proper training and oversight.

Recommendations

The Directors, Customer Account Services, in the Small Business/Self-Employed and Wage and Investment Divisions should:

1. Ensure employees receive the appropriate training (i.e., Limitations on Credit or Refund) before

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

working the “OPEN” status listing so taxpayers’ accounts will be properly credited.

Management’s Response: Management’s response was due on July 23, 2001. As of July 25, 2001, management had not responded to the draft report.

2. Include the “OPEN” status listing in its ongoing quality review process to ensure the appropriate transfer of all available credits to taxpayers’ accounts.

Procedures and Computer Programming Changes Should Decrease the Number of Payments in the Excess Collections Accounts

The IRS’ Excess Collections Task Force was instrumental in the implementation of several changes that should decrease the number of payments in the Excess Collections Accounts.

The IRS’ Excess Collections Task Force has been instrumental in the implementation of several changes that should decrease the number of payments transferred to the Excess Collections Accounts. This group was formed during our prior audit. We worked with the task force to develop recommendations to improve internal processes and customer satisfaction.

Several IRM procedural changes have been made. For example, examiners are now instructed that, “under certain circumstances, when you cannot transfer or refund a credit, ... leave the credit on the account and internal programming will automatically move the credit to Excess Collections Accounts at a later date.”

Beginning in July 2001, a monthly listing of all credits in “OPEN” status with a received date of 3 years or less will be generated. Credits included on this list will be reviewed every 6 months. Research will be performed on each credit to determine possible application to taxpayer’s accounts.

Since many taxpayers have payments in the IRS’ Excess Collections Accounts that cannot be refunded because tax returns were filed after the statute for refunding has expired, a second computer programming change was scheduled to be implemented in April 2001 for

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

individual accounts and May 2001 for business accounts. This change will affect taxpayer accounts where a credit is on the module but a tax return has not been filed. The IRS has developed two notices to advise taxpayers of a credit balance in their account. The first notice is to remind taxpayers that they have not filed a tax return and have a credit balance in their account. The second notice is an alert to taxpayers that the credit in their account is about to expire due to the statute of limitations for claiming a credit or refund. Both notices provide an explanation of the law regarding the refund statute of limitations.⁵

A third computer programming change was scheduled for implementation in January 2001, involving situations where payments have been transferred to the Excess Collections Accounts and then a tax return is received after the due date. Generally, if a credit has been transferred from the taxpayer's account and a tax return is later received showing a balance due, a notice may be generated to the taxpayer requesting payment.

To avoid sending this erroneous notice to the taxpayer, an internal notice (transcript) will be sent to the IRS' Notice Review function. Examiners will be alerted to review the taxpayer's account for a credit that has been transferred to Excess Collections Accounts. The examiner will then manually request that the credit be transferred from the Excess Collections Account back to the taxpayer's account, to be credited toward the taxpayer's liability.

These corrective actions will provide better customer service and solve problems for taxpayers.

The full effect of these corrective actions is not yet measurable. However, we believe these changes will reduce erroneous balance due notices and enforced collection actions. These corrective actions will also provide better customer service by preventing and solving problems for taxpayers.

⁵ Internal Revenue Code 26 U.S.C. § 6511(a), Limitations on Credit or Refund (1998).

**Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit
for Millions of Dollars in Excess Collections Accounts**

Conclusion

In order to properly apply credits from its Excess Collections Accounts to taxpayers' accounts, the IRS needs to ensure employees receive the appropriate training and oversight. This will provide better customer service and prevent taxpayer problems by addressing them as early as possible.

**Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit
for Millions of Dollars in Excess Collections Accounts**

Appendix I

Major Contributors to This Report

Gordon C. Milbourn III, Assistant Inspector General for Audit (Small Business and
Corporate Programs)

Philip Shropshire, Director

Edmond Watt, Audit Manager

William Floyd, Senior Auditor

Carole Connolly, Auditor

Ronald Stuckey, Computer Specialist

**Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit
for Millions of Dollars in Excess Collections Accounts**

Appendix II

Report Distribution List

Commissioner N:C
Deputy Commissioner N:DC
Chief Counsel CC
Director, Communications, Small Business/Self-Employed Division S:COM
Director, Customer Account Services, Small Business/Self-Employed Division S:CAS
Director, Customer Account Services, Wage and Investment Division W:CAS
Director, Internal/External Stakeholders, Small Business/Self-Employed
Division, Compliance Policy S:C:CP:I
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
National Taxpayer Advocate TA
Office of Management Controls N:CFO:F:M
Audit Liaisons:
Commissioner, Small Business/Self-Employed Division S
Commissioner, Wage and Investment Division W

Letter Report: Increased Oversight Is Needed to Ensure Taxpayers Receive Credit for Millions of Dollars in Excess Collections Accounts

Appendix III

Outcome Measures

This appendix presents detailed information on the measurable impact that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:

- Taxpayer Rights and Entitlements – Actual; \$62.6 million credited to taxpayers' accounts (see page 4)

Methodology Used to Measure the Reported Benefit:

Using computer matching techniques we developed, the Internal Revenue Service (IRS) was able to credit \$62.6 million from its Excess Collections Accounts back to the taxpayers' accounts based on the second "clean-up" listing we provided. Initially, the IRS credited back \$49.9 million from the second "clean-up" listing. However, we determined that an additional \$12.7 million could also be transferred back based on a sample of 236 payments from those identified by the IRS as not being able to be credited to the taxpayers' accounts. All payments were verified by the IRS and have since been credited back to the taxpayers' accounts.